

City of Rockville Retirement Board

November 14, 2008

PRESENT: Alex Espinosa, Chairperson; Cpl. Jan Seilhamer, FOP Representative; Anita McCombs, AAME Representative; Kyle France, Union Representative; Phyllis Marcuccio, Councilmember; Carlos Vargas for City Manager. Also in attendance were Gavin Cohen, Executive Secretary to the Board; Mary Johnson, Personnel Administrator; Tim Peifer, Financial Systems Manager; Marsha Mathis and Michael Clark, Principal Financial Group; as well as George Kiriakos, Segal Advisors.

The meeting commenced at 10:00 a.m. and started with introductions.

I. Appointment of Chairperson/Welcome New Members to the Committee:

Mr. Cohen introduced the new Chairperson, Alex Espinosa, and mentioned that he was pleased to see the FOP and Union Representatives attending.

II. Approval of Minutes from December 7, 2007:

Mr. Espinosa asked for a motion for approval of the minutes from the December 7, 2007 meeting. Mr. Vargas made the motion to approve the minutes as presented and Councilperson Marcuccio seconded it. All were in favor.

III. Review of Actuarial Valuation Report dated 4/1/2008:

Mr. Clark started by going through the summary of the actuarial valuation report that he prepared and handed out before the meeting started. He began on page two with a brief explanation as to how the annual required contribution is calculated. Page three explains the actuarial accrued liability. It measures the present value of expected benefit payments to plan participants. The interest rate currently used for discounting based on the expected long-term rate of return on plan assets is 7.75%. The entry age normal cost method considers service to date and the impact of future salary increases. The actuarial accrued liability was \$66.9 million at April 1, 2008. Page four reflects the actuarial value of assets. It shows that the market value of plan assets experienced a 3.6% rate of return during the 2007 plan year. The market value loss for the year was approximately \$7 million. The actuarial value of assets smoothes gains and losses over four years so the impact on the valuation is tempered. The actuarial assets return rate was 6.2%. The actuarial value of assets is \$63.9 million as of April 1, 2008. Mr. Espinoza asked how often a full experience study is done. Mr. Clark said that the assumptions are reviewed annually, but a full experience study has not been done recently. Mr. Cohen asked if the Board was concerned about the interest earnings percentage used for the valuation and the way it is done. He asked if the Board wanted Mr. Clark to take a different look at it. Councilperson Marcuccio said she would be nervous with a lower number because the unfunded liability could look worse. Mr. Clark said the two major items to look at are interest and mortality rate. He said that he would have to prepare a proposal to do a full experience study. He continued going through the report. He said that the unfunded actuarial accrued liability as of April 1, 2008 was \$3 million. Page six shows that the market value of the plan asset value was \$59,978,049 and the actuarial value of the plan asset value was \$63,868,591 as of April 1, 2008. Page seven shows historic information between the market value of assets and the actuarial value of assets. It reflects the historic gains and losses over four years. There is a loss of \$1.8 million currently. He said that for every million that is put in it would reduce the unfunded liability by \$100,000. He said that it is necessary to talk about strategies to fund this. Mr. Kiriakos said to keep in mind that paying now will be a much better rate than next year and is lower now than it has been in ten years. Mr. Clark continued with the assets vs. liabilities. The report was separated into the two groups nonpolice and police. Page eleven is the history of contributions as a percent of total pay. The last page shows the projected annual required contributions. The red line assumes by March 31, 2009 that there will be an upward trend of contribution levels, by 2010 there would be a \$2-\$3 thousand difference in returns and by 2011 it would level out. The Board requested that Mr. Clark prepare a proposal to look at whether or not the plans assumptions are correct especially if the 7.75% rate currently using for the annual required contribution needs to be lower.

IV. Review of Quarterly Performance Reports October 1, 2007-December 31, 2007, January 1, 2008-March 31, 2008, April 1, 2008-June 30, 2008, July 1, 2008-September 30, 2008:

Mr. Kiriakos said to set aside all the performance reports since that information no longer pertains due to

what was happening in the market place. He brought the latest reports. He started with some background, concept, and history of how this country got into the financial crisis. He stated that the American dream is to own your own home but that it becomes a different prospect when owning a home is used for financial gain. He said that we are living beyond our means as individuals and as a country. He said the country is running a large deficit in the balance of accounts in the last decade due to the large amount of dollars flowing overseas particularly to the Mid-East (for oil) and China (manufactured goods), two areas of the world that still peg their currencies to the dollar. As a result they can not absorb the influx of dollars and instead reinvest them in U.S. Treasury securities which has the effect of lowering interest rates in the U.S. making borrowing even cheaper for the ever hungry U.S. Consumer.

Mr. Kiriakos then started to go through the memo regarding Market Conditions. He concentrated on page two of the memo. It states that with the investment results of the first nine months of the year that retirement plan sponsors will likely see double digit losses in their third quarter reports. It also states that even as painful as it is to experience this type of market volatility and loss of value in fund assets that we should keep in mind that periods of economic uncertainty and dramatic market downturns occur periodically and should not be a reason to abandon long-term investment strategy; no single asset class dominates from year to year and diversifying across multiple asset classes and securities provides risk control and should minimize return volatility; avoid market timing and that October 13th is a great example of how this one day offset 50% of the market decline over the first eight business days of the month; bear markets recover and since 1957 there have been eleven down periods that produced an average loss on the S & P 500 of 23% and the initial twelve month return after the decline had an average return of +35%. Mr. Kiriakos attempted to reassure the Board that the City would find a way through the downturn and recovery. Councilperson Marcuccio asked what the current loss is? Mr. Kiriakos responded that it was 12%. Mr. Kiriakos continued and said the index would rollover just prior to a recession and that the index usually recovers before the economy. He said that it will be difficult for the new administration and congress to control themselves and his advice to the government would be to proceed with caution. He went over the preliminary performance analysis through October 31st and said that the Real Estate allocation piece helped to diversify the fund and protect it from more significant losses in other areas of the market. He said he did not like the 6.9% loss in the Principal Fixed Income, but has seen it as bad as 14%.

LUNCH 11:50-12:15

The meeting resumed. Mr. Cohen first asked if there were any questions. There were none and Mr. Kiriakos continued with the Thrift report. He started with page 7, which shows the activity for the quarter. The total decline for the quarter was \$491,371.00. Page 8 reflects how the money is allocated. The top two on the list are the most conservative and most of the participants are in those. Mr. Kiriakos asked Mr. Cohen what was the default account if a person does not select and Mr. Vargas responded that the Life Cycle Fund is used. Mr. Espinosa asked if the City conducts education seminars. The response was yes and that the next topic will be on rebalancing. Mr. Kiriakos continued with the Performance Summary. He stated that if the Principal Mid Cap Stock Fund continues to improve it would come off the watch list. He said that the next account to keep a watch on is the Principal Small Company Value Account. Mr. Espinosa inquired what it means to put a fund on the watch list. Mr. Kiriakos explained that the fund is watched for six months and if does not improve it is replaced with another fund. He also suggested that the Board should meet more often than once a year.

V. Discussion and Adoption of Pension Plan Investment Policy:

Mr. Kiriakos gave a presentation of the pension plan investment policy. Mr. Cohen stated that it serves as the basis for managing plan assets. Mr. Espinosa asked if this was a rewrite? Mr. Kiriakos said that some language was taken out and that a Segal template was used that was formed based on best practices. He said that the 4th paragraph on page 1 was the most important. He continued and explained that on page 2 paragraph 2 and 3 outlay the Boards fiduciary obligation. He stated that everyone on Board is to act in the best interest of the participants. The end of page 3 is tied to the target allocation. The bottom of page 5 reflects the target allocation. Mr. Kiriakos will touch base with Mr. Cohen at the end of the year regarding asset allocation at that time. Mr. Cohen stated that real estate and small cap equity were recently added and need to have a discussion to see if can maintain earnings assumption at 7.75%. Mr. Kiriakos said that the plan has a fairly diversified portfolio and the asset allocation model is done every 3 years and would not change anything right now. Page 6 is the rebalancing guidelines and Segal will advise if that needs to be done. Page 10 is general information and page 11 is asset class investment guidelines. Mr. Vargas made a motion to approve based on no one coming forward with opposing conditions. Councilperson Marcuccio seconded. All were in favor.

Mr. Cohen said he would contact Mr. Kiriakos with dates to meet in March. Mr. Clark, Ms. Mathis, and Mr. Kiriakos left at 1:15.

VI. Discussion and Recommendation of Retiree COLA for 2009:

Mr. Cohen stated that some plans have COLAs built in and that ours is ADHOC. He explained that the Board meets each year to decide if a COLA should be granted. He stated that the staff recommends no COLA for this year due to losses and that we should not add to the unfunded liability. Councilperson Marcuccio recommended that the Board take a prudent approach and agreed with the need to hold it down. A motion was made to support staff. Mr. France seconded. Ms. Seilhammer opposed. It passed with a 5-1 vote.

VII. Discussion re: Board Responsibilities as GASB 45 Trustees:

Staff will be requesting to have the Board appointed as trustees of the trust fund that will be established. It will require fiduciaries to oversee the trust. This item is due to go to the Mayor and Council and recommended that the Board serves as trustee to manage investments and money in this trust. Staff will be asking the Mayor and Council to approve the establishment of this trust and the Retirement Board to be administrators of that trust. Mr. Kiriakos said the trustees should decide on different investment managers. He said that this is separate from pension and the ARC will be \$1.3 million dollars. It will be handled something like a mutual fund and be really diversified.

VIII. Authorization to Proceed with Regulatory Plan Amendments:

Mr. Cohen stated that language changes needs to be made to the Plan due to IRS regulations and request the authority of the Board to use the Pension Plan attorney to proceed with language changes. Mr. Cohen is looking for approval from the Board to change plan for regulatory purposes. All were unanimous to proceed.

IX. Discussion for Future Agendas June 2009 Board Meeting:

The items to be discussed at the next meeting will be:

- Board Members Fiduciary Duties and Responsibilities
- Board Members Liability Coverage
- Actuarial Earnings Assumption – Experience Study

Mr. Espinosa made motion to adjourn and was seconded by Councilperson Marcuccio at 1:40 p.m.. All were in favor.